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Message Text

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TO SECSTATE WASHDC 5673
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C O N F I D E N T I A L SECTION 1 OF 3 BOGOTA 9973

EO 11652: GDS
TAGS: ECON EFIN ENRG CO
SUBJ: REVIEW OF ECONOMIC EMERGENCY MEASURES

REF: A. BOGOTA 9333; B. BOGOTA 9095

SUMMARY: DURING THE PAST TWO MONTHS THE LOPEZ ADMINISTRATION, PRIMARILY THROUGH THE DECREE POWERS OF ECONOMIC EMERGENCY, HAS ENACTED A SERIES OF REFORMS WHICH WILL HAVE A PRONOUNCED EFFECT ON THE COLOMBIAN ECONOMY. MOST OF THE NEW MEASURES ARE OF A FISCAL AND MONETARY NATURE AND BY CORRECTING IMBALANCES IN THESE AREAS ARE DESIGNED TO COMBAT INFLATION AND PROMOTE INCOME REDISTRIBUTION. THE PROGRAM HAS NOT BEEN WITHOUT POLITICAL COSTS TO THE ADMINISTRATION. ALMOST ALL SECTORS OF THE ECONOMY HAVE BEEN CRITICAL OF THE REFORM PACKAGE: BUSINESS, BECAUSE ITS COSTS WILL BE INCREASED AND BECAUSE IT WAS NOT CONSULTED REGARDING THE REFORM PROCESS; LABOR AND LOWER INCOME GROUPS, BECAUSE THE REFORMS HAVE NOT RESULTED IN AS RAPID AND EXTENSIVE BENEFITS
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AS THEY HAD HOPED FOR; CONSUMERS, BECAUSE LIVING COSTS HAVE

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CONTINUED TO RISE RAPIDLY - PARTLY AS A RESULT OF THE NEED TO ADJUST PRICES TO REALISTIC LEVELS AS A FIRST STEP IN COMBATTING INFLATION. THE ADMINISTRATION HAS MADE REVISIONS IN A NUMBER OF ITS ORIGINAL DECREES WHICH WERE PROBABLY A PREDICTABLE RESULT (ALTHOUGH NOT EXPRESSLY ADMITTED) OF BOTH INITIAL OVERSIGHT AND ERROR. IT HAS NOT, HOWEVER, BACKED OFF UNDER PRESSURE TO ANY SIGNIFICANT DEGREE FROM THE BASICS OF ITS PROGRAM. DESPITE RATHER STRONG CRITICISM OF BOTH POLICIES AND PROCEDURES, THE LOPEZ ECONOMIC PACKAGE THUS FAR APPEARS TO CONTAIN MODERATE AND GOOD-QUALITY REFORMS WHICH STAND A REASONABLE CHANCE OF ACHIEVING THE INDICATED GOALS. WHILE THE FULL IMPACT OF THE MEASURES ON OVERALL ECONOMIC PERFORMANCE WILL NOT BE CLEAR FOR SOME TIME, THE UNUSUALLY HIGH LEVEL OF EXPANSION OF THE PAST SEVERAL YEARS WILL ALMOST CERTAINLY BE REDUCED. AT THE SAME TIME, THE LOPEZ ADMINISTRATION THUS FAR APPEARS TO BE TURNING IN A REASONABLE PERFORMANCE IN THE DIFFICULT TASK OF ATTEMPTING TO MAINTAIN ACCEPTABLE GROWTH RATES WHILE COMBATTING EXCESSIVE INFLATION. END SUMMARY.

1. PRESIDENT LOPEZ EMPHASIZED THROUGHOUT HIS CAMPAIGN AND IN THE PRE-INAUGURAL PERIOD THAT THE PRINCIPAL TASKS FACING HIS ADMINISTRATION WOULD BE CONTROL OF INFLATION AND REDISTRIBUTION OF INCOME. FIVE WEEKS AFTER HIS INAUGURATION HE ANNOUNCED A 45-DAY STATE OF ECONOMIC EMERGENCY PURSUANT TO THE PROVISIONS OF ARTICLE 122 OF THE CONSTITUTION. THE EMERGENCY PERIOD WAS UTILIZED TO ISSUE A NUMBER OF DECREES WHICH SIGNIFICANTLY ALTER FISCAL AND MONETARY SYSTEMS AS WELL AS WAGE AND PRICE STRUCTURES. NOT ALL OF THE MEASURES REQUIRED EMERGENCY POWERS AND A NUMBER OF ADDITIONAL REFORMS ARE EXPECTED THROUGH NORMAL DECREE FACULTIES AND THROUGH LEGISLATION. THE MAJOR REFORMS ANNOUNCED DURING (AND SURROUNDING) THE ECONOMIC EMERGENCY PERIOD ARE AS FOLLOWS (WITH REFERENCE CABLE NUMBER): ELIMINATION OF WHEAT SUBSIDY (8275), REDUCTION OF EXPORT TAX CREDITS (8493) AND COMPENSATING MEASURES (9336), REVISION OF SALES TAX (8493), REVISION OF INCOME TAX (8704 AND 8868), NUMEROUS MONETARY ADJUSTMENTS INCLUDING INTEREST RATE AND RESERVE REQUIREMENT CHANGES (8491), NEW CREDIT FACILITIES (9485) AND ADDITIONAL REVENUE BONDS (9776), GOVERNMENT AUSTERITY (8491 AND 8375), PRICE FREEZES AND ADJUSTMENTS (8375 AND 9660), ALTERATION OF PETROLEUM AND NATURAL GAS POLICIES (9660 AND 8375), AND INCREASE CONFIDENTIAL

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IN MINIMUM WAGES AND OTHER BENEFITS (9776); DECREES WERE ALSO ISSUED TO REVISE SIGNIFICANTLY THE EARLIER SALES AND INCOME TAX MEASURES (9776) AND MONETARY RESTRICTIONS (9485).

2. THE ABOVE MEASURES WERE DESIGNED TO REDUCE INFLATION BY CUTTING BACK ON MONETARY EXPANSION RESULTING FROM GOVERNMENT DEFICIT FINANCING. THE GOC HOPES THAT ITS ACTION ON SUBSIDIES, AUSTERITY, REVENUE BONDS, AND SALES AND INCOME TAX WILL RESOLVE

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FISCAL DIFFICULTIES WHICH LED THE PREVIOUS ADMINISTRATION TO UTILIZE EXTENSIVE COMMERCIAL FOREIGN BORROWING AND CENTRAL BANK CREDITS. AT THE SAME TIME CREDIT EXPANSION HAS BEEN RESTRICTED AND STEPS TAKEN TO RATIONALIZE INTEREST RATES IN ORDER TO PROMOTE A MORE MARKET-DETERMINED FINANCIAL STRUCTURE. INCOME AND SALES TAXES ARE HEAVILY GRADUATED TO FAVOR LOWER INCOME GROUPS, AND A TAX ON CAPITAL GAINS FINALLY INSTITUTED; TAX WITHHOLDING HAS BEEN REDUCED; MINIMUM WAGES WILL BE INCREASED BY 35-40 PERCENT; AND PRICES FOR SOME ITEMS HAVE BEEN FROZEN (FURTHER ACTION IN THIS AREA IS EXPECTED) AND STIFF PENALTIES IMPOSED FOR VIOLATIONS. THESE MEASURES COMBINED WITH SPECIAL PRODUCT DISTRIBUTION EFFORTS ARE DESIGNED TO CORRECT THE DECLINE IN REAL WAGES OVER THE PAST SEVERAL HEARS. RESTRICTIONS ON RE-DUCTIONS IN LABOR FORCE ARE ALSO EXPECTED.

3. SURFACE REACTION TO THE REFORM MEASURES HAS BEEN ALMOST UNIVERSALLY CRITICAL. BUSINESS ORGANIZATIONS COMPLAIN THAT THEIR COSTS WILL BE EXCESSIVE, CONSUMPTION WILL DECLINE, EXPORTS WILL NO LONGER BE COMPETITIVE, WORKING CAPITAL WILL NOT BE AVAILABLE, AND THAT THEIR TAX BURDEN ZILL BE UNBEARABLE. LABOR, WHILE LESS VEHEMENT, WANTED GREATER SALARY BENEFITS AND MORE PRICE RESTRICTIONS AND IS CONCERNED OVER THE POSSIBILITY OF INCREASED UNEMPLOYMENT. THE CONSUMER IN GENERAL IS DISTURBED BY COST OF LIVING INCREASES RESULTING FROM HIGHER SALES TAXES AND PRICE ADJUSTMENTS. THIS CRITICISM, HOWEVER, MUST BE PLACED IN PROPER PERSPECTIVE. DESPITE THE LOPEZ ELECTORAL "MANDATE FOR CHANGE" A LARGE SEGMENT OF THE COLOMBIAN SOCIETY IS INHERENTLY

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CONSERVATIVE AND CRITICAL OF ANY CHANGE ACTUALLY REALIZED. FURTHERMORE, SOME OF THE CRITICISM BY BUSINESS PROBABLY STEMS MORE FROM THE MANNER OF CHANGE THAN FROM ITS SUBSTANCE. THE BUSINESS SECTOR HAS TRADITIONALLY BEEN HEAVILY INVOLVED IN THE DECISION-MAKING PROCESS, BUT THE LOPEZ ADMINISTRATION RELIED ON ITS OWN TEAM OF TECHNOCRATS AND ANNOUNCED ITS DECISIONS AS FAIT ACCOMPLI.

4. PUBLIC REACTION HAS RESULTED IN REVISION OF SOME OF THE ORIGINAL DECREES, PARTICULARLY THOSE RELATING TO SALES AND INCOME TAXES. PART OF THIS REVISION CAN BE CLASSIFIED AS REFINEMENT TO ELIMINATE PROBLEMS IN THE ORIGINAL VERSIONS WHICH WERE PROBABLY INEVITABLE GIVEN THE LIMITED FORUM. IN OTHER INSTANCES ADMINISTRATION OFFICIALS WERE APPARENTLY CONVINCED BY THE PRIVATE SECTOR THAT THE ECONOMIC IMPACT WOULD BE TOO SEVERE. WHILE THERE HAVE BEEN SUGGESTIONS THAT THE GOC INTENTIONALLY TOOK AN INITIAL POSITION IN ADVANCE OF ITS GOALS IN ORDER TO FACILITATE ITS FALL-BACK POSITION, THE EMBASSY WOULD NOT AS YET CLASSIFY CONFIDENTIAL

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THE REVISIONS AS CAVING-IN TO PRESSURES (ALTHOUGH ITS RETREAT ON BANK RESERVE REQUIREMENTS AND METHOD OF PLACING TREASURY BONDS MAY BE RATHER CLOSE TO THIS). SOME DIFFICULT STEPS SUCH AS OVERHAUL OF PETROLEUM PRICES AND RELATED SUBSIDIES HAVE BEEN POSTPONED BUT THIS APPEARS TO STEM MORE FROM THE DESIRE TO REDUCE THE NEGATIVE ECONOMIC IMPACT RATHER THAN UNWILLINGNESS TO FACE HARD DECISIONS.

5. WHILE SOME HAVE QUESTIONED THE ADMINISTRATION'S DECISION TO SKIRT THE NORMAL DEMOCRATIC PROCESS BY UTILIZING THE DECREE MECHANISM, HIGH MARKS MUST STILL BE GIVEN FOR THE QUALITY OF THE NEW LAWS. FURTHERMORE, THIS QUALITY IS GREATER THAN COULD HAVE BEEN ACHIEVED THROUGH THE CONGRESS. THE PROPENSITY OF THE CONGRESS TO DILUTE AND DELAY REFORM MEASURES WAS ALMOST CERTAINLY THE MAJOR REASON FOR LOPEZ TO CHOOSE THE COURSE OF ECONOMIC EMERGENCY.

6. DESPITE THE LAUDABLE NATURE OF THE NEW MEASURES, IT REMAINS TO BE SEEN HOW EFFECTIVE THEY WILL BE IN REDUCING INFLATION AND INCOME INEQUITIES. AS A MEANS OF DECREASING THE GOVERNMENT DEFICIT ONLY THE SALES TAX, ELIMINATION OF THE WHEAT SUBSIDY,

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AND TO A LESSER EXTENT REDUCTION OF THE EXPORT TAX CREDIT WILL RESULT IN SIGNIFICANT BENEFITS DURING 1975. BY 1976 THE REVENUE IMPACT SHOULD BE CONSIDERABLY GREATER. THE GOC IS APPARENTLY NOT CUTTING BACK ON ITS EXPENDITURES TO THE EXTENT ORIGINALLY EXPECTED AND THE PROCEDURE FOR FLOATING TREASURY BONDS HARDLY DIFFERS FROM CENTRAL BANK BORROWING. AT THE SAME TIME, ITS 1974 CASH FLOW DEFICIT WILL APPARENTLY BE LESS THAN THAT OF THE PAST TWO YEARS AND TOTAL INCREASE IN THE MONEY SUPPLY WILL BE MODEST IN COMPARISON TO LAST YEAR. EVEN THOUGH GOC EFFORTS TO CONTROL INFLATION WILL PROBABLY NOT BE AS SUCCESSFUL AS WE HAD ORIGINALLY EXPECTED, THESE STEPS SHOULD SERVE TO DAMPEN INFLATIONARY PRESSURE NEXT YEAR. THE SHORT-TERM BENEFITS TO LOWER-INCOME WORKERS ARE PROBABLY AS GREAT AS COULD HAVE BEEN REASONABLY EXPECTED. THE MORE IMPORTANT LONGER-TERM BENEFITS WILL DEPEND LARGELY ON SUCCESS IN CONTROLLING INFLATION AND IN IMPLEMENTING MORE TIMELY FUTURE WAGE INCREASES TO COMPENSATE FOR COST OF LIVING INCREASES.

7. TO THE EXTENT IT CAN BE ISOLATED FROM IMMEDIATE BENEFITS AND LOSSES, THE MAJOR UNCERTAINTY IN THE MINDS OF MOST COLOM-
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BIANS IS HOW THE REFORM PACKAGE WILL AFFECT THE OVERALL PERFORMANCE OF THE ECONOMY. THE SLOW-DOWN UNDERWAY AT THE TIME OF THE LOPEZ INAUGURATION WAS SHARPLY ACCENTUATED DURING THE EMERGENCY PERIOD. SOME ECONOMIC ACTIVITIES HAVE SPURTED IN ORDER TO BEAT DEADLINES OF NEW MEASURES (EXPORTS, SALES OF LUXURY ITEMS, AND IN THE PAST WEEK REAL ESTATE TRANSACTIONS), BUT FOR THE MOST PART BOTH BUSINESS AND CONSUMER HAVE BEEN AWAITING A CLEARER DEFINITION OF ECONOMIC POLICY. WITH THE END OF THE YEAR AT HAND AND WITH SOME POLICIES SUCH AS SPECIFIC ACTIONS ON PRICE CONTROLS NOT YET CLARIFIED, NO REAL TRENDS WILL PROBABLY BE DISCERNIBLE UNTIL EARLY 1975. HOWEVER, IT IS ALMOST UNIVERSALLY AGREED THAT GDP GROWTH RATES WILL BE LOWER IN 1975 THAN IN THE PAST SEVERAL YEARS. AMONG THOSE WILLING TO MAKE CONCRETE ESTIMATES THE RANGE VARIES FROM ABOUT 3 TO 6 PERCENT GROWTH ALTHOUGH OTHERS PREDICT EVEN MORE SERIOUS RECESSION.

8. AS NOTED BOGOTA 9095, CONSTRUCTION AND EXPORTS, TWO MAJOR FACTORS IN RECENT EXPANSION, WILL ALMOST CERTAINLY SHOW LESS DYNAMISM. UNEMPLOYMENT IS LIKELY TO INCREASE AT LEAST IN THE SHORT RUN. A KEY QUESTION WILL BE WHETHER AGRICULTURE CAN BE STIMULATED BOTH TO COMPENSATE FOR THE OTHER SECTORS AND TO REDUCE PRESSURE ON THE COST OF LIVING. APART FROM AN INDICATED GOAL OF INCREASING PRODUCTION, THE LOPEZ AGRICULTURAL POLICY LARGELY REMAINS TO BE DEFINED AND MOST STIMULI CAN ONLY BE DIRECTED TOWARD MEDIUM AND LONG TERM RESULTS. AT THE SAME TIME IT APPEARS THAT NEW INVESTMENT PLANS BY BOTH DOMESTIC AND FOREIGN CAPITAL CONTINUE TO BE SUBSTANTIAL. THE DEMAND FOR CREDIT FOR BOTH PLANT AND EQUIPMENT EXPENDITURES AND FOR WORKING CAPITAL

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REMAINS STRONG. FURTHERMORE, DESPITE THE RISE IN THE BLACK
MARKET DOLLAR RATE, WHICH GENERALLY REFLECTS FLIGHT CAPITAL,
NEW SAVINGS HAVE INCREASED AT A REASONABLE RATE DURING THE PAST
THREE MONTHS. THE GOVERNMENT IS ALSO TAKING STEPS TO BOLSTER
CONFIDENCE IN THE HOUSING-ORIENTED SAVINGS AND LOAN SYSTEM
AND TO INCREASE CONSTRUCTION ACTIVITIES OF OFFICIAL AGENCIES.

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SOME COMPENSATION FOR LOSS OF THE EXPORT TAX CREDITS IS BEING
PROVIDED THROUGH ACCELERATED DEVALUATION AND INCREASED FINANCING.

9. THE POLITICAL COSTS OF THE ECONOMIC MEASURES TO THE LOPEZ
ADMINISTRATION ARE, AS YET, HARD TO GUAGE. GIVEN THE SIZE OF
HIS ELECTORAL VICTORY, LOPEZ HAD POLITICAL CAPITAL TO SPARE.
THE ATTITUDES OF KEY GROUPS AT THE TIME OF HIS ELECTION ALSO
GAVE LOPEZ A SUBSTANTIAL AMOUNT OF LATITUDE; I.E., THE UPPER
INCOME GROUPS ACKNOWLEDGED THAT SOME CHANGES IN THE NATION'S
ECONOMIC STRUCTURE WERE NECESSARY; THE LOWER INCOME GROUPS
LOOKED FORWARD TO THE INCOME REDISTRIBUTION THAT HAD BEEN
IMPLIED THROUGHOUT THE LOPEZ CAMPAIGN AND TO RELIEF FROM THE

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INFLATION THAT HAS HIT THEM HARDEST AND THAT LOPEZ PLEDGED TO FIGHT.

10. THE ADMINISTRATION'S ECONOMIC REFORMS MAY, IN TIME, ACCOMPLISH MUCH OF WHAT LOPEZ PROMISED. FOR THE PRESENT AND THE NEAR TERM FUTURE, HOWEVER, THE RESULTS, ARE DISPLEASING, CONFIDENTIAL

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NOT ONLY TO THE MANAGEMENT SECTOR AS NOTED ABOVE, BUT TO THE LOWER ECONOMIC GROUPS AS WELL. UNFORTUNATELY, LOPEZ PRIOR TO HIS INAUGURATION EMPHASIZED HIS PLANS FOR RAPID CHANGE DURING THE FIRST 100 DAYS WHILE DEVOTING LESS ATTENTION TO ACKNOWLEDGING THAT INFLATION AND INCOME DISTRIBUTION PATTERNS CANNOT BE REVERSED (WITHOUT TRAUMATIC CONSE-
QUENCES) IN SUCH A
PERIOD. LOWER INCOME GROUPS ARE THUS DISTURBED BY THE FACT THAT COST OF LIVING INCREASES DURING OCTOBER WERE THE HIGHEST IN TEN YEARS, WITH MANY OF THE PRICE RISES, FOODSTUFFS PARTICULARLY, HITTING THEM VERY HARD. THE INCREASES IN THE MINIMUM WAGE SCALE (SEPTEL) ARE VIEWED BY MANY AS LESS THAN ADEQUATE TO COMPENSATE FOR RISING PRICES, AND AS ACCOMPLISHING NOTHING IN THE WAY OF INCOME REDISTRIBUTION. MOVES SUCH AS THE REMOVAL OF THE WHEAT SUBSIDY, WHILE PROBABLY BENEFICIAL IN THE LONG RUN, HAVE FOR THE PRESENT MEANT ONLY HIGHER PRICES FOR BREAD AND PASTA. THE CUTBACK IN CONSTRUCTION EMPLOYMENT, UNLESS ALLEVIATED, COULD HAVE SERIOUS EFFECTS IN THE NEXT SEVERAL MONTHS. THE WORKERS AFFECTED ARE LARGELY CONCENTRATED IN THE LARGER CITIES WHERE A GROUPING OF RECENTLY UNEMPLOYED WORKERS COULD BECOME POLITICALLY VOLATILE.

11. THE LOPEZ ADMINISTRATION THUS FACES A DISENCHANTMENT THAT IS NOW WIDESPREAD. UNLESS THE ECONOMIC PROGRAM BEGINS TO SHOW RESULTS, PARTICULARLY IN STEMMING INFLATION, WHILE AVOIDING A SERIOUS ECONOMIC SLOW-DOWN, THE DISCONTENT COULD DEEPEN AND BECOME A SERIOUS OBSTACLE TO THE LOPEZ ADMINISTRATION'S FUTURE PROGRAMS.

12. THE EMBASSY ENCOUNTERS CONSIDERABLE DIVERGENCE IN OPINION AS TO THE OVERAL PERFORMANCE OF THE ECONOMY DURING THE NEXT COUPLE OF YEARS. SOME BUSINESSMEN SPEAK OF MASSIVE LAYOFFS AND REDUCED ACTIVITY RESULTING FROM HIGH INVENTORIES AND DIMIN-
ISHED DEMAND. OTHERS UTILIZE THE TERM "GUARDED OPTIMISM" AND NOTE THAT WHILE AN ATTACK ON INFLATION REQUIRES A REDUCTION IN DEMAND THEY EXPECT THE ECONOMY TO CONTINUE TO OPERATE AT FAIRLY HIGH OUTPUT LEVELS. NEGATIVE APPRAISALS APPEAR MORE MARKED IN SOME PARTS OF THE COUNTRY, SUCH AS MEDELLIN AND CALI, THAN IN OTHERS. AT THE SAME TIME THE INTENSITY OF CRITICISM APPEARS TO HAVE DECLINED SOMEWHAT DURING THE PAST TWO WEEKS FOLLOWING REVISIONS IN TAX LAWS AND SOFTENING OF CREDIT LIMITATIONS. IN CONFIDENTIAL

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ANY EVENT THE FULL IMPACT OF THE MEASURES WILL ONLY BECOME APPARENT OVER SOME CONSIDERABLE PERIOD OF TIME. THE EMBASSY BELIEVES THAT THE LOPEZ ADMINISTRATION IN FACT HAD LITTLE REAL CHOICE IN MOVING TO DAMPEN INFLATIONARY PRESSURES IF IT WERE TO AVOID THE VIRTUAL CERTAINTY OF AN ACCELERATING DETERIORATION IN THE ECONOMY. DRAWING THE FINE LINE BETWEEN MAINTENANCE OF ACCEPTABLE RATES OF GROWTH ON THE ONE HAND AND RESTRAINING EXCESSIVE INFLATION ON THE OTHER IS AN INEXACT ART NO EASIER TO PERFORM IN COLOMBIA THAN ANYWHERE ELSE. AT THE SAME TIME, WE BELIEVE THE MEASURES THE GOC HAS ADOPTED TO COPE WITH THE SITUATION ARE WELL-DESIGNED AND MODERATE - EVEN ORTHODOX - AND HAVE AT LEAST A REASONABLE PROSPECT OF SUCCESS.
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